

***United States Court of Appeals
for the Second Circuit***



**BRIEF FOR
APPELLEE**

76-7076

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P/s

IN THE
United States Court of Appeals
For the Second Circuit

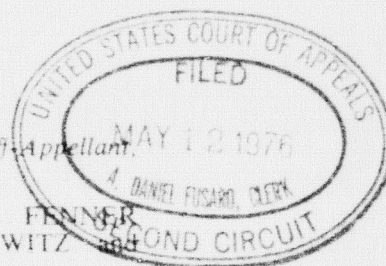
Docket No. 76-7076

MILDRED A. McLEARN,

Plaintiff-Appellant,

v.
COWEN & CO., MERRILL LYNCH, PIERCE, FENNER
& SMITH INCORPORATED, BARRETT SINIWITZ
LEONARD FUCHS, individually,

Defendant-Appellees.



ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE SOUTHERN DISTRICT OF NEW YORK

BRIEF FOR DEFENDANT-APPELLEE
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INCORPORATED

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IN THE
UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT
DOCKET NO. 76-7076

Mildred A. McLearn,

Plaintiff-Appellant,

v.

Cowen & Co., Merrill Lynch, Pierce, Fenner
& Smith Incorporated, Barrett Siniwitz and
Leonard Fuchs, individually,

Defendant-Appellees.

On Appeal from the United States District Court for
the Southern District of New York

BRIEF FOR DEFENDANT-APPELLEE
MERRILL LYNCH, PIERCE, FENNER & SMITH INCORPORATED

PRELIMINARY STATEMENT

Plaintiff-Appellant ("Plaintiff") appeals from a final judgment entered in the United States District Court for the Southern District of New York on January 15, 1976 pursuant to an opinion and order of the Honorable Charles M. Metzner, dated January 12, 1976, dismissing her action for failure to allege fraud with sufficient particularity as required by Rule 9(b) of the Federal Rules of Civil Procedure. This opinion and order has not been officially reported.

QUESTION PRESENTED

Did the District Court err in finding that plaintiff's amended complaint failed to allege fraud with sufficient particularity?

STATEMENT OF FACTS

This action was commenced in the United States District Court for the Southern District of New York on March 31, 1975. The complaint, which consisted of thirty-nine pages containing one hundred three paragraphs, alleged in the most general and conclusory terms that the named plaintiff and two of her relatives were defrauded by two brokerage firms, Cowen & Co. and Merrill Lynch, Pierce, Fenner & Smith Incorporated ("Merrill Lynch"), and by certain individual defendants.

The defendants moved to dismiss the complaint under Rules 12(b) and 9(b) of the Federal Rules of Civil Procedure for failure to allege fraud with the requisite particularity. In an opinion and order dated July 30, 1975, Judge Metzner dismissed the complaint, with leave to replead, for the following reasons:

"I agree that [the complaint] sets forth plaintiff's position, but not the facts and circumstances constituting the alleged fraud. That is what is required, and that is what plaintiff has failed to allege with particularity. Bare

conclusory allegations of fraud are insufficient."*
(Emphasis in original)

The amended complaint was filed on September 30, 1975. It also contained 103 paragraphs. It is identical with the former complaint except for the expansion and repetition of one paragraph in each of the eight counts. These eight expanded paragraphs, which apparently constitute the heart of the amended complaint, consist of a single diatribe against brokers which is repeated six times against Cowen & Co. (§§ 18, 28, 59, 69, 77 and 87, at 6-13a, 15-17a, 29-30a, 33-34a, 37-38a and 41-42a)** and two more times against Merrill Lynch (§§ 49 and 99 at 24-26a and 45-47a) on behalf of plaintiff and two of her relatives.

For example, in paragraph 49 of the amended complaint the plaintiff alleged that Merrill Lynch "acted in bad faith, failed to exercise prudent judgment and breached the fiduciary obligation owed by the defendant to the plaintiff ..., that the stocks purchased for her were speculative in nature and involved substantial risk for a person in plaintiff's position which position was known to the defendants and each of them" that Merrill Lynch failed "to establish a

* See pages 13-15, *infra*. Judge Metzner's Opinion and Order of July 30, 1975, dismissing the first complaint, was omitted from Plaintiff-Appellant's Appendix, which was printed and served without compliance with Rule 30(b), F. R. A. P. A copy of this Opinion and Order is annexed to this Brief for the convenience of the Court.

** The suffix "a" used herein refers to the pages of the Appendix for Plaintiff-Appellant.
"A. Br." refers to the Brief for Plaintiff-Appellant.

system for monitoring adverse developments as to allow defendants to make appropriate decisions when adverse developments were perceived...". Further that Merrill Lynch bought "speculative stocks margined to the limit and [bought] stocks at too high a price level historically and in relation to indicators of value..." 24-25a No securities are mentioned by name. No specific transactions are referred to. No details of any kind are given.

As stated above, the same boilerplate allegations were made six times on behalf of three people against the Cowen & Co. defendants, where different facts presumably were involved.*

On January 12, 1976 Judge Metzner dismissed the amended complaint and judgment was entered on January 15, 1976 (3a). The Court found that the Amended Complaint "fails to correct the deficiencies of the original one ... [P]laintiff has merely added more conclusory allegations and restated those of the original complaint The changes are in language rather than in substance. The complaint still fails to set forth the facts and circumstances of the alleged fraud and must be dismissed". (4a)

* Even the slight variations between the paragraphs applying to Merrill Lynch and those applying to Cowen & Co. do not illuminate the nature of plaintiff's complaint. For example, plaintiff alleges that the Cowen & Co. defendants induced her and her relatives into giving them a complete power of attorney. See ¶¶ 9, 26, 57, 67, 75 and 85. (9a, 15a, 29a, 32a, 36a, 40a) The corresponding allegation against Merrill Lynch, however, is that it "refus[ed] to accept the power of attorney thereby escaping the responsibility ..." ¶¶ 49 and 99. (26a, 47a)

ARGUMENT

PLAINTIFF FAILED TO PLEAD
HER ALLEGATIONS OF FRAUD
WITH THE REQUISITE PARTICULARITY
AND THE DISTRICT COURT PROPERLY
DISMISSED HER AMENDED COMPLAINT

It is settled law in this Circuit that broad, conclusory allegations are insufficient to support a complaint under Rule 10b-5. As this Court stated in Segal v. Gordon, 467 F.2d 602, 607 (2d Cir. 1972), "Mere conclusory allegations to the effect that defendant's conduct was fraudulent or in violation of Rule 10b-5 are insufficient," quoting Shemtob v. Shearson, Hammill & Co., 448 F.2d 442, 444 (2d Cir. 1971. See also O'Neill v. Maytag, 339 F.2d 764, 768 (2d Cir. 1964) ("[T]here must be allegation of facts amounting to deception" or a cause of action grounded on fraud will be dismissed); Goldberg v. Shapiro, [1974-1975 Transfer Binder] CCH Fed. Sec. L. Rep. ¶94,813 at 96,717 (S.D.N.Y. 1974) ("Rule 9(b) requires particularized pleading of 'circumstances' - not simply facts or elements of a cause of action"); Zammas v. Jagid, [1973-1974 Transfer Binder] CCH Fed. Sec. L. Rep. ¶94,342 at 95,157 (S.D.N.Y. 1973), "These counts do not allege with any particularity which statements are attributable to which defendants and the circumstances in which they were made. They fail the test of Rule 9(b) Federal Rules of Civil Procedure, and must be dismissed"; Leonard v. Colton [1967-1969 Transfer Binder] CCH Fed. Sec. L. Rep. ¶92,284 at 97,371 ("[A] complaint which alleges fraud must be more specific

than the notice pleading, which is adequate for other complaints in federal courts"). See also F.R.Civ.P. Rule 9(b).

The reasons for the requirement of pleading fraud with particularity have been summarized as follows:

"The requirement that allegations of fraud be pleaded with particularity stems from, among other sources, a concern that potential defendants be shielded from lightly made public claims or accusations charging the commission of acts or neglect of duty which may be said to involve moral turpitude. 5 C. Wright & A. Miller, Federal Practice and Procedure, § 1296. The need for this protection is most acute where the potential defendants are professionals whose reputations in their field of expertise are most sensitive to slander. See *Felton v. Walston and Co., Inc.*, 508 F.2d 577, 581-82 (2d Cir. 1974). Apart from the prejudicial and in terrorem effects of fraud allegations, a defendant in a fraud action requires particularized information in order to understand what conduct is complained of and to prepare a defense to such a claim of misconduct." *Rich v. Touche Ross & Co.* 68 F.R.D. 243, 245 (S.D.N.Y. 1975)

The Plaintiff's Amended Complaint - though admittedly prolix - completely fails to satisfy these settled requirements. Nowhere are any facts pleaded which set forth with particularity the fraud alleged. Nowhere are the circumstances of the alleged wrongdoing set forth.

In *Goldberg v. Shapiro*, supra, at 96,717, the Court specifically rejected a conclusory complaint that alleged without particularity "understatements" and "overstatements" in a financial statement because:

"There is no mention of specific amounts understated or overstated (by Touche Ross), no mention of who, specifically caused the understatement or overstatement, no allegation of the circumstances of misconduct save for the bare allegations mentioned above. There is, in short, insufficient particularity." [Emphasis added].

In Levy v. First National City Bank, 75 Civ. 1335 (S.D.N.Y. August 26, 1975), Judge Owen found the complaint to be inadequate:

"... defendant is entitled to know what the contents were of the 'doubts about the management of UDC' ... the allegations state only that certain items were 'not adequately disclosed.' These allegations should specify those statements made ... and indicate to what extent they are false, inaccurate, or insufficient and/or state precisely what statements should have been made ... [d]efendants are entitled to know in what specific ways plaintiff claims that the financial picture ... was distorted or incomplete ..."

So, too, should this Court reject plaintiff's conclusory and vague allegations of bad faith, misrepresentation and failure to "heed adverse economic developments". As this Court held in Segal v. Gordon, supra, "A complaint cannot escape the charge that it is entirely conclusory in nature merely by quoting such words from the statutes as 'artifices, schemes and devices to defraud' and 'scheme and conspiracy'". 467 F.2d at 608.

The allegations here are "merely conclusory and clearly do not apprise the defendants of the claims made against them Some further explanation of the allegations is necessary to indicate how they constitute fraud". Felton v.

Walston & Co., 508 F.2d 577, 581 (2d Cir. 1974). For example, no mention is made in the amended complaint of who specifically caused or made any representation, and to whom. Similarly absent are any allegations which describe the circumstances under which the author or authors of the representation caused it to be made, that is, the whens and wheres of the alleged fraudulent representations. The amended counts do not reveal any specific representations with respect to any specific securities transactions, which representations are the essential elements of a claim for securities fraud under the Securities Exchange Act of 1934, 15 U.S.C. §78a et seq. (1971).

Plaintiff's unsubstantiated and conclusory pleadings fail to comply with the Supreme Court's recent decision in Ernst & Ernst v. Hochfelder, 44 U.S.L.W. 4451 (March 30, 1976), wherein it was held at 4454 that "a private cause of action for damages will not lie under §10(b) and Rule 10b-5 in the absence of any allegations of 'scienter' - intent to deceive, manipulate, or defraud". The Supreme Court dismissed the complaint because it charged only negligence and not scienter, and expressly refused to remand for further proceedings.

The amended complaint fails to apprise the defendants of specific accounts of fraudulent misrepresentations or how and when they may have occurred in connection with any purchase or sale of a security. See Blue Chip Stamps v. Manor Drug Stores, 421 U.S. 723, 756 (1975).

The plaintiff has failed in her brief to point out a single instance where the amended complaint sets forth any allegations of fraud with requisite particularity. She merely reiterates the general statutory language that the District Court found insufficient. Finally, it must be pointed out that she has failed to cite a single case that is contrary to the appellees' position.

Plaintiff cites this Court's opinion in Segal v. Gordon supra, for the proposition that "the requirements of Rule 9(b) should be relaxed as to matters within the adverse parties [sic] knowledge." A. Br. 8. However, the rule actually set down by this Court is:

"The allegations violate the general rule that Rule 9(b) pleadings cannot be based 'on information and belief'. While the rule is relaxed as to matters peculiarly within the adverse parties' knowledge, the allegations must then be accompanied by a statement of the facts upon which the belief is founded." 467 F.2d at 608.

Plaintiff asserts that she need not plead "evidentiary matters" and that any factual revelations must await the discovery process. A similar assertion was answered as follows in Rich v. Touche Ross & Co., supra:

"At this early stage in these proceedings, plaintiffs' pleadings should not be judged by the standard to be applied on trial of the ultimate merits. However, it is not an unreasonable burden to expect the plaintiffs to be able to identify the misstatements, omissions or fraud that caused them to engage in particular securities transactions.

See Schlick v. Penn-Dixie Cement Corporation, 507 F.2d 374 (2d Cir. 1974)." 68 F.R.D. at 247.

Indeed in discussing Schlick v. Penn-Dixie Cement Corporation, 507 F.2d 374 (2d Cir. 1974) (A. Br. 8), the plaintiff fails to take note of Judge Oakes' remarks at p. 378:

"We go first to the 10b-5 count of the complaint. That count does allege generally 'the engagement in a course of business which operated as a fraud and deceit on the purchasers and holders of Continental Stock'. If that were all that were alleged, it would fall within the court's rule that 'mere conclusory allegations to the effect that defendant's conduct was fraudulent or in violation of Rule 10b-5 are insufficient'."

The fact is, every case that plaintiff has cited stands for the principle that averments of fraud must be stated with particularity and "should be simple, concise and direct". See Conley v. Gibson, 355 U.S. 41 (1957) (A. Br. 9); Brady v. Games, 128 F.2d 754 (D.C. Cir. 1942); Selzer v. Bank of Bermuda Ltd., 385 Supp. 415 (S.D.N.Y. 1974) (A. Br. 6); Seligson v. Plum Tree, Inc., 61 F.R.D. 343 (E.D. Pa. 1973) (A. Br. 7); Collins v. Rukin, 342 F. Supp. 1282 (D. Mass. 1972) (A. Br. 6). The Amended Complaint does not comply with this rule. As Judge Metzner pointed out in his opinion dismissing the original Complaint, "Plaintiff relies on Rule 8(e) of the Federal Rules of Civil Procedure requiring clear and concise pleading to avoid the necessity of pleading with particularity. Such position is incongruous when applied to a thirty-nine page complaint". (p. 13 infra.) The amended complaint has forty-four pages. (6-49a)

It is clear that plaintiff has not given the defendants adequate notice of her claim, and the mere use of statutory boilerplate does not apprise the defendants of the grounds upon which relief is sought.

CONCLUSION

The appellant's arguments on appeal are unsubstantiated and entirely without merit. This appeal is clearly an unjustified attempt to salvage an amended complaint that has failed to meet the test of Rule 9(b) even under the most liberal interpretation.

The judgment of the District Court should be affirmed by this Court, with costs.

Dated: New York, New York
May 12, 1976

Respectfully submitted,

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Opinion of Judge Metzner

July 30, 1975

UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

----- x
MILDRED A. McLEARN, :
 :
Plaintiff, : 75 Civ. 1563
 :
-against- :
 :
COWEN & CO., MERRILL LYNCH PIERCE, :
FENNER & SMITH, INCORPORATED, :
BARRETT SINIWITZ and LEONARD FUCHS, :
Individually, :
 :
Defendants. :
 :
----- x

METZNER, D. J.:

Defendant Cowen & Company (Cowen) moves to dismiss the complaint for failure to allege fraud with sufficient particularity pursuant to Rule 9(b) of the Federal Rules of Civil Procedure, and in the alternative, for an order directing plaintiff to file a more definite statement pursuant to Rule 12(e). Defendant Merrill Lynch, Pierce, Fenner & Smith, Inc. (Merrill Lynch) has joined in Cowen's motion.

The complaint alleges violations of Section 10(b) of the Securities Exchange Act of 1934, 15 U.S.C. § 78j(b), and Rule 10b-5 promulgated thereunder, and Sections 205

Opinion of Judge Metzner

July 30, 1975

and 206, as amended, of the Investment Advisers Act of 1940, 15 U.S.C. §§ 80b-5, 80b-6.

The complaint runs thirty-nine pages and in one hundred three paragraphs sets forth eight counts, all in general terms alleging a fraud based on breach of fiduciary duty and tracing the boilerplate language of the statutes and regulations involved.

Plaintiff contends that "[t]he complaint sets forth, in great detail, plaintiff's position." I agree that it sets forth plaintiff's position, but not the facts and circumstances constituting the alleged fraud. That is what is required, and that is what plaintiff has failed to allege with particularity. Bare conclusory allegations of fraud are insufficient. Felton v. Walston & Co., 508 F.2d 577 (2d Cir. 1974); Segal v. Gordon, 467 F.2d 602 (2d Cir. 1972). Cf. Segan v. Dreyfus Corporation, Docket No. 74-1012 (2d Cir. March 28, 1975).

Plaintiff relies on Rule 8(e) of the Federal Rules of Civil Procedure requiring clear and concise pleading to avoid the necessity of pleading with particularity. Such position is incongruous when applied to a thirty-nine page complaint.

Opinion of Judge Metzner

July 30, 1975

Accordingly, the complaint is dismissed
with leave to file an amended complaint within twenty
days of the date of this order.

So ordered.

Dated: New York, N.Y.
July 30, 1975

CHARLES M. METZNER
U. S. D. J.

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CHASE NATIONAL PLAZA N.E.C.

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